

WPS 0770

Policy, Research, and External Affairs

WORKING PAPERS

Socialist Economies Reform

Country Economics Department
The World Bank
September 1991
WPS 770

Privatization in Eastern and Central Europe

Objectives, Constraints, and Models of Divestiture

Farid Dhanji
and
Branko Milanovic

The privatization process must be seen as transparent and absolutely above reproach and the rules of the "market" game must be clearly enunciated and adhered to in divestitures. Improvements in economic performance will be considerably diluted if the new market economy is based on an extensive network of special privileges.

This paper — a joint product of the Socialist Economies Reform Unit, Country Economics Department, and the Country Operations Division, Country Department IV, Europe, Middle East, and North Africa Regional Office — is part of a larger effort in PRE to study transition in formerly planned or non-market economies. This is a revision of a paper prepared for the Conference on Privatization and Ownership Changes in Central and East Europe held at the World Bank in Washington, DC in June 1990. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact CECSE, room N6-025, extension 37188 (28 pages). September 1991.

This paper is devoted largely to a taxonomic discussion of objectives, constraints, and models of divestiture in privatization programs, but Dhanji and Milanovic also present some concluding observations.

The plethora of divestiture options makes choice difficult. From an individual government perspective, the choice of preferred model will vary depending on the objectives, the weights given to the objectives, and the estimation of practical difficulties in implementation. In this respect, there is no correct answer about how to privatize. Decisions are highly political, mediated through still inchoate political processes, invoking strong interests and lobbies, and with a genuine possibility of popular backlash in societies sensitive to wide discrepancies in wealth.

Privatization models are not exclusive. It may be possible, in fact, to combine solutions

that give workers and managers a stake in their firms, grant a proportion of enterprise equity to the general population (either directly or through mutual funds), and provide revenue for the state through general sales. Such combined options are beginning to surface in privatization debates.

During the period when firms are being readied for divestiture, governments can be expected to be besieged by waves of requests for exemptions, concessions and protection from firms about to be privatized or from prospective owners. It will be extremely important to resist these pressures. The improvement in economic performance that is one of the major objectives of reform programs will be considerably diluted if the new market economy is based on an extensive network of special privileges. Moreover, experience from elsewhere testifies to the difficulty of removing concessions once given.

Table of Contents

	Page
Introduction	1
I. Objectives of Privatization	1
A. Introduction of a Market Economy	2
B. Increasing Economic Efficiency	3
C. Establishing Democracy and Guaranteeing Political Freedoms	4
D. Increasing Government Revenue	5
E. The Inconsistency of the Objectives	5
II. The Environment for Divestiture in Reforming Socialist Economies	6
A. Politics: The Actors	6
B. The Legal Framework	8
C. Enterprise Readiness for Privatization	9
D. Demonopolization	9
E. Valuation	10
F. Enterprise Restructuring	11
G. The Financial Environment	12
H. The Fiscal Environment	13
I. The Administrative Environment	14
III. Typology of Privatization: Advantages and Disadvantages of Different Options	14
A. Internal Privatization	16
B. External Privatization - Giveaway to All Domestic Citizens	18
C. External Privatization - Sales to Individuals	19
D. External Privatization - Foreign Investors	22
E. External Privatization - The Role of Institutional Investors	22
F. Holding Companies	24
Conclusions	25
Bibliography	27

This is a revision of the paper prepared for the Conference on Privatization and Ownership Changes in Central and East Europe, organized by CECSE and EMENA4 and held at the World Bank in Washington, D.C., June 13 - 14, 1990. We thank Cecilia Guido-Spano for the presentation of the paper.

Privatization in East and Central Europe Objectives, Constraints, and Models of Divestiture

Farid Dhanji and Branko Milanovic^{1/}

INTRODUCTION

This essay has been prepared for the Conference on Ownership Changes and Privatization in the Reforming Economies of East and Central Europe. It is a taxonomic exploration of many issues that have emerged. It seeks not to take sides in debates but rather to point out the reasons behind the positions advanced, with a modest but by no means conclusive commentary. Divestiture of State assets--and sometimes it is questionable whether assets do belong to the State!--is a lively topic in every country in the region. Hungary has moved farthest in passing legislation and, in the process, has experienced some controversial privatization episodes; its laws may well be amended by the new, democratically elected government. Poland, at the time of writing, is embroiled in a profound discussion over the contents of a privatization law before parliament. Yugoslavia has begun passing legislation. Elsewhere, laws are being thought about and discussed.

The plan of this paper is as follows. In Section I, we consider the various objectives of privatization programs in the region. In Section II, the environment for divestiture is described and the constraints and barriers to privatization delineated. We conclude with an analysis of the more prominent models advanced for privatization, with a discussion of advantages and disadvantages.

I. OBJECTIVES OF PRIVATIZATION^{2/}

Many motivations have been given for privatization in the reforming socialist economies. We focus here on four such objectives, subsuming others under these headings:

- Introducing a market economy.
- Increasing economic efficiency.
- Establishing democracy and guaranteeing political freedoms.
- Increasing government revenue.

The logic of each claim is examined below.

A. Introduction of a Market Economy

"Introduction of a market economy" is the most frequent rallying cry of economic reform movements--"market" without adjectives," as Czechoslovakia's Finance Minister has declared. In an important sense this motivation stems from a highly negative response to the failures of the socialist

^{1/} The text reflects work in progress and the authors' personal views.

^{2/} We define privatization as the transfer of ownership from the public to the private sector. Other definitions stipulate transfer of control (Hemming and Mansoor 1988), or entitlement to residual profits (Yarrow 1986).

economic model over 40 years. These failures are well-known: growth has largely halted and the economic engine appears to have lost capacity for providing sustained improvements in welfare; shortages of consumer goods are frequent and occasionally intense; the standard of living (including environmental conditions) is considerably lower than in virtually all countries of Western Europe. Hope of material improvements appears dim. The contrast with the successful "market" economies is stark.

Adoption of a slogan is not sufficient, however, to give it content. The "market" is widely perceived as an extraordinary coordinating mechanism for decentralized economic decisionmaking. The new reformers go farther in maintaining that markets must be based on extensive systems of private property rights; privatization thus forms a central pillar of the program to create market economies. In this, the reformers take exception to a long line of socialist thinking that has argued that the decentralized coordination implied by the market is compatible with state ownership of the means of production.^{3/} The difference in position is partly theoretical, partly derived from experience.

From theory, the reformers argue that although the State is the nominal owner of capital, it cannot exercise the interests of a real owner--that is, protect its assets and control their use. It is hampered by the "distance" (in an informational sense) that exists between itself and individual enterprises, by the sheer scale of the coordination problem, and, most importantly, by a fundamental incentive flaw, namely, the lack of an unambiguous link between the efficiency with which capital is used and the return to the State. Since State capital is owned by everyone, it tends to be treated as "no one's property." It is constantly subject to two types of threats: misallocation, as exemplified by the low efficiency with which it is invested, and spoliation (decapitalization). In this view, only private ownership--with private owners directly interested in capital and profits--can form the basic institutional building block of the market economy.

To support the argument is to appeal to experience. Various reforms have been conducted in many socialist economies over the years. These have tried to provide greater play to market forces by granting enterprises greater autonomy in decisionmaking. A major attempt to implement decentralized public ownership has been going on in Yugoslavia since at least the mid-1950s. Similar attempts have characterized reforms in Hungary since 1968, in Poland since 1982, and in China in the 1980s. With the exception of rural reforms in China, these attempts have, by and large, been viewed as failures. In the best analyzed reforms^{4/}--Hungary's--it has been noted repeatedly that even when the State no longer legally retains the right to micromanage enterprises, that does not significantly diminish State interference in economic decisionmaking; it only takes a different form. Enterprises switch from being directly regulated to being indirectly regulated through preferential access to credits, discretionary taxation, and special subsidies. Bureaucratic meddling continues, partly as a reflex reaction to the potential loss of privilege and power, but also because of the fundamental flaw noted above: the lack of private owners to whom incentives matter.

Creating a market economy is thus seen as inextricably tied to the establishment of the institution of private property and the privatization of State assets. Indeed, some have gone farther and argued

3/ For recent expressions see Horvat (1989); Kowalik, quoted in Sarjusz Wolski (1989); Bugaj (1989).

4/ Kornai (1986).

that the entire success of reform programs is predicated upon a quick and early privatization program.^{5/} It is said that the absence of clearly defined property rights is responsible not only for incentive failures but has created the entire institutional and economic crisis of the socialist State. The lack of supply responsiveness at the enterprise level, the near insolvent condition of financial systems, the absence of labor and capital markets are traced to one cause: the inescapable motivational basis of the market economy is missing. Reforms along one or two fronts--for instance, in restructuring the financial system or encouraging labor mobility--are bound to fail, since the transmission belt for eliciting the expected response from economic stimuli will not work. In this view, the creation of extensive private property rights and the early divestiture of State assets are necessary conditions for credible and successful reform efforts.

B. Increasing Economic Efficiency^{6/}

Raising economic efficiency through privatization of State assets is a second major objective of reform programs. This is a fairly traditional objective of privatization programs everywhere. The expected efficiency gains are divided into: (1) productive efficiency--producing the same or higher levels of output at lower cost; (2) X-efficiency--the cluster of improvements to be gained from better organization, management, and motivation; (3) efficiencies from escaping bureaucratic regulation and indirect management; in most respects these are simply a combination of the improvements available under (1) and (2); and, finally (4) allocative efficiency--resources become employed in their most productive and most valued uses, as prices reflect relative scarcities. A pivotal condition for allocative efficiency is the freedom of enterprises to enter dynamic and growing sectors and to exit from declining sectors or unprofitable activities.

Most would agree that efficiency gains from (1), (2), and (3) are likely to be substantial. Socialist enterprises are notoriously inefficient in their use of materials and energy; the majority suffer from overmanning; many are engaged in activities that have little to do with their core business. Economic rationalization, coupled with vigorous attention to costs and profits, will considerably improve performance. These gains are likely to occur even if enterprises remain monopolies in private hands or continue to operate in highly concentrated sectors, for there will still be substantial incentives to reduce costs and increase profits. The gains will certainly be greater if firms are exposed to foreign competition.^{7/8/}

5/ Hinds (1989) is an eloquent expositor and proponent of this view; the editors of *The Economist* magazine are converts; see the Survey article, *Perestroika*.

6/ See van de Walle (1989) for a discussion of these objectives in the context of developing economies.

7/ In an early study of Swedish industries, Carlsson (1972) found that even in highly concentrated sectors, firms exposed to international competition showed strong improvement in productive and X-efficiency. Scherer and Ross (1990), pp. 648-54, review further evidence along these lines.

8/ In this regard the debates in market economies about privatization, which often swirl around comparisons of efficiency and productivity between the private and public sectors, cannot be considered altogether relevant for socialist economies. To begin with, the scale of the problem is quite different: in socialist economies, 70-90 percent (in terms of value added) is typically produced by state-owned enterprises, compared to 5 - 10 percent in developed OECD countries. Second, publicly owned enterprises in OECD countries are surrounded by market-oriented enterprises, and they themselves operate in a commercial and legal environment vastly different from the coordinated, bureaucratic milieu of socialist enterprises. Third, in developed economies much of the public sector consists of "natural" monopolies; in socialist economies the bulk of the State sector consists of potentially competitive industries where there is no presumption in favor of public ownership.

The notion that allocative efficiency will be improved by privatization is more difficult for some to accept. Allocative efficiency is often considered "more a function of market structure" than of ownership.^{9/} As expressed by other analysts, "the degree of competition typically [has] rather larger effects...than ownership per se."^{10/} Stimulating competition by breaking up monopolies then becomes an important objective in securing overall efficiency gains. To put it differently, there is not much allocative improvement to be found in turning "public" monopolies into "private" ones.

It is arguable how far this view can be defended in socialist settings. Gains in allocative efficiency can only be achieved when factors of production are free to move. By and large, this is not the case now. Labor is generally immobile due to structural reasons (such as lack of housing), past policies of overmanning and guaranteed job security, and undifferentiated wage structures. Capital mobility has been secured, in a manner of speaking, through centrally administered allocations of credit and redistributions of tax revenues from enterprise to enterprise, but the process has paid little attention to efficiency considerations. Most important, resources are locked in present uses through the failure to enforce bankruptcies. If privatization allows for greater labor mobility, for more efficient capital investing, and for release of resources through bankruptcies, then gains in allocative efficiency will be achieved even with the continued persistence of monopolistic or highly concentrated market structures. While this does not deny that further gains in allocative efficiency can be obtained by creating competitive market structures, it does suggest that the rationale for breaking up monopolies before privatizing them may be less overwhelming in socialist settings than in market economies.

C. Establishing Democracy and Guaranteeing Political Freedoms

The most openly ideological interest in privatization is the belief that economies based on private property are better at establishing democratic political institutions and preserving individual freedoms than economies where the productive apparatus is socially owned.^{11/} It can, of course, be debated at some length whether East and Central Europe's great extension of State power from the economic to the civil realm was a necessary concomitant of the socialist system. It can also be averred that not always, and not everywhere, have capitalist economies been stalwart defenders of democracy or bastions of human freedom. These points are not conclusive to radical reformers, who entertain the strong conviction that only under systems of extensive private property do social mechanisms arise to limit the power of States through democratic political arrangements.

This conviction inspires the objective of spreading ownership as widely as possible: the wider the spread, the greater the bulwark against destruction of the new and preferred political institutions. Spreading ownership also makes destruction of the new economic system more difficult. As historical episodes of nationalization show, expropriation does not raise major problems when ownership has been concentrated among the few. Public attitudes are different when everyone is a property owner.

9/ Hemmings and Mansoor (1988), p. 18.

10/ See Vickers and Yarrow (1988), p. 3.

11/ "The system of private property is the most important guarantee of freedom, not only for those who own property, but scarcely less for those who do not." (Hayek 1944, pp. 103-4.) The idea has an illustrious pedigree in the writings of, to name a few, Locke, Mill, and more recently Mises (1922), pp. 185-95, and Friedman (1962). Schumpeter (1943) argued that democracy was possible under both socialism and capitalism, although he further suggested that a socialist democracy would, because of the controls it would need to exercise over economic behavior, have less tolerance for human freedoms.

in addition, widespread ownership can be defended from the point of view of another "primary" value: equality. A society with dispersed ownership is likely, *ceteris paribus*, to be more egalitarian than one with concentrated ownership.^{12/}

D. Increasing Government Revenue

Privatization is also viewed as a means for raising government revenues. Funds are raised almost instantly when the State reduces its subsidies to inefficient firms and sells their assets. Revenues are raised permanently if the economy moves to a higher growth path as a result of privatization and taxes are thus higher than they would otherwise be.

The expectation of permanently increased revenues is crucially dependent upon privatization improving enterprise economic performance. If we assume that enterprises are initially sold at their value (equal to the discounted sum of net future profits received by the State), and that their efficiency remains the same after privatization, then the State's long-term revenue position does not improve through sales. All that happens is that the State exchanges an earning asset (an enterprise) for cash; it substitutes further earnings for present income.^{13/}

During economic crisis, with the need for fiscal stringency and the possibility of popular unrest, it is understandable that governments will particularly support the objective of raising revenue through privatization. These revenues can, after all, substitute in the short term for increased taxes. There will, however, be macroeconomic constraints to be heeded. If, for instance, privatization is used to retire a large monetary overhang, then for the government immediately to return this purchasing power to the economy will be inflationary. The disposition of revenues cannot, in short, be disassociated from the immediate macroeconomic setting, nor can the long-term establishment of a sustainable fiscal system be permanently postponed.

The objective of raising revenues through privatization is not without further controversy. The argument is often made that all assets that are socially owned should be distributed free to citizens: after all, they "own" them in the first place, and it seems invidious to sell people something they already own. This view is sometimes coupled with a further suggestion that the sale of assets is likely, for a variety of reasons, to be so slow as to subvert the hoped-for economic gains that quick and extensive property ownership will provide. These arguments are taken up in Section III.

E. The Inconsistency of the Objectives

In the numerous episodes of privatization in other countries, inconsistency in objectives has often been remarked upon. Of Britain's privatization, for instance, it has been observed:

^{12/} Samuel Brittan (1988), p. 300, has suggested that the distribution of shares in state-owned companies could represent the first step toward giving each citizen a guaranteed minimum income (derived as the investment income from the "citizen bundle" of shares). Dispersion of ownership would thus be directly combined with welfare policy.

^{13/} Revenues from asset sales simply represent a transformation of one form of State property (physical assets) for another (cash). They should accordingly be treated as an asset exchange similar to a sale of bonds: in other words, the conventional deficit should not be manipulated to give a misleading picture of the state of fiscal finances. For some reason, however, sale revenues in Britain reduce a most widely used measure of the government deficit--the Public Sector Borrowing Requirement (PSBR).

At different times, each of these objectives--revenue, efficiency, finance, wider share ownership -- has been sacrificed for others. There has been no consistent rationale for the policy of privatization; rather, it has appeared to meet particular political needs at particular moments in time.^{14/}

Certain inconsistencies may also come into play in socialist privatization programs.

Most pronounced are likely to be conflicts between quick privatization--to establish the new economic and political systems rapidly--and the objects of raising revenue and increasing efficiency. As noted above, selling assets will take a long time; it would be much simpler and quicker to distribute them free. Moreover, if governments decide to sell, it is expected that the lower the prices, the easier and more rapid the sales. Sales can also be expedited, against the grain of achieving efficiency, by selling enterprises as monopolies or by offering tariff or tax concessions.

Increased economic efficiency and dispersed ownership may also pose difficulties. If ownership is too dispersed, the link between the share-owning individual and the performance of the enterprise would almost be as weak as in the previous (state-dominated) system. The failure of a single dominant owner to emerge might allow managements considerable latitude to perform inefficiently. Some compromise with the ideal of an egalitarian "property-owning democracy" might then be sought, accepting a greater concentration of ownership and wealth in order to secure improved economic performance.^{15/}

There are probably no "solutions" to these inconsistencies, since they are inherent in the nature of the objectives themselves. But governments would do well to be aware of them in formulating privatization strategies.

II. THE ENVIRONMENT FOR DIVESTITURE IN REFORMING SOCIALIST ECONOMIES

Divestiture of enterprises is, at best, not easy. In reforming socialist economies the obstacles are formidable; viewed from the outset, the process appears considerably more complicated than divestitures that have occurred in other parts of the world. In this section we review some complicating factors and constraints that both shape the debates about ownership change and determine the feasible actions available to makers and implementers of policy.

A. Politics: The Actors

The Workers. Industrial workers in Hungary, Poland, and Yugoslavia are insistent that they should at minimum have an important ownership stake in the enterprises where they have worked.^{16/} The existence of enterprise councils giving workers a prominent stake in decision-making (Hungary and Poland) and of self-management (Yugoslavia) has reinforced this sentiment at the plant level. (In

^{14/} Bishop and Kay (1989), p. 643.

^{15/} Some privatization schemes explicitly acknowledge this problem as, for example, Kornai (1989).

^{16/} "Public opinion polls conducted in early 1989 showed that 67 percent of workers in medium-sized companies and 41 percent in large companies favored private ownership. However, only 22 percent of workers accepted a takeover by investors not working in the company, while 47 percent were opposed. Employee ownership had the overwhelming support of 71 percent of the polled." (Walkowiak, Breitkopf, and Jaszczynski 1990, p. 79.)

Czechoslovakia, for a brief period between 1987 and 1989, workers also exercised a managerial role in enterprises.) Only in Poland have industrial workers organized into national trade unions^{17/} been capable of strongly entering the political arena. National organization may not, however, be necessary for workers to express their will. Incidents at enterprise level--workplace malfeasance, strikes, or promised industrial conflict--would be sufficient to deter divestiture.

Workers, in some respects, have the most to lose from privatization. At the moment they receive some proportion of the residual enterprise income after fixed charges have been met; they can often dictate how large that proportion will be. But in the future, workers will face lower real wages and unemployment through plant closures and redundancies. It seems inevitable, therefore, that ways must be found to include workers in the new property dispensation.

The Managers. "Spontaneous privatizations" have affected Hungary, Poland, and Yugoslavia. The manifestations have been various. But they have generally involved managers imaginatively exploiting loopholes in the evolving transformation and ownership legislation so as to transfer ownership or use of enterprise assets to themselves--usually at a fraction of real worth. Managers have also, on occasion, sold assets to foreigners or incorporated enterprises as joint ventures with foreign partners, making themselves the major beneficiaries. The assets and sums involved have not been small.^{18/} Public outcry has been sharp and intense, not least because these takeovers have been engineered through networks of privileged *nomenklatura*.

Government officials know that procedures for divestiture must be transparent and fair, since there is a potential for severe backlash if the public begins to equate privatization with "rip-offs." At the same time, the confidence of managers must be retained if privatization is to succeed. Indeed, one of the strongest engines of privatization is to harness the self-interest of managers in preparing their firms for the private sector.^{19/} There is no alternative managerial elite waiting in the wings to take over from incumbents. And like workers, managers will want some equity stake in the firms where they work. They will act to obtain it.

The Politicians. Privatization in the reforming socialist economies is quintessentially a political phenomenon. It invokes debates on profound questions about the nature of a good society, and about the kind of society reform should aim to achieve. The distribution of wealth between individuals and between classes, the relations of power between owners, managers, and workers--these are two of the more contentious questions that arise in designing the scope and rules of divestiture. To say that privatization is essentially or even mainly a technical problem, where the chief difficulties lie in lack of markets and institutional deficiencies, appears excessively simple and unrealistic. Observation suggests a very high degree of domestic politicization of these debates, as interests clash and lobbies compete for influence.

17/ OPZZ, the official Communist Trade Union, and Solidarity; OPZZ has reportedly been gaining many new members, eclipsing Solidarity membership in the process.

18/ For details of some of these occurrences see the papers by Walkowiak et al (1990), Madzar (1990), and Miszei (1990). In Hungary spontaneous transformations have touched the country's largest electric bulb manufacturer, a major producer of medical equipment, and one of the largest producers of motor vehicles. In Poland the largest agro-industrial firm has been taken over in a *nomenklatura* privatization.

19/ See Alan Walters, "Privatization" (mimeo), on the importance of this fact for the British privatization experience.

The new elites that are emerging generally espouse privatization as the instrumental remedy for the failures of the socialist economic model. The old elites, however discredited, do not necessarily agree. It is hypothesized here, however, that active opposition to privatization from the old elites--with their bases of support in the bureaucracy, among managers, and in the armed forces--will be small. Much more likely will be attempts to use political and administrative processes to turn privatization to their own advantage.

Those who favor privatization, while sharing a common goal, do not always agree on the scope, methods, or speed of the process. For the moment these differences appear muted in a prevailing atmosphere of technocratic setting of agenda. With a sharper crystallization of party and group affiliation (as has occurred in Hungary) these differences can be expected to be more prominent. And as privatization gets into full swing, political pressures from both potential losers and potential winners are likely to become intense. Likewise, rent-seeking or pressures for financial and economic privilege or protection by newly privatized firms will be strong. These two latter features have complicated divestiture everywhere. The political management of privatization will then become a major--if not the most important--conditioning factor for the success of reform programs.

B. The Legal Framework^{20/}

One of the great challenges facing reforming socialist economies is to institute a systematic body of law governing the activities of agents in a market economy. In addition, an entire judicial system (courts, judges, lawyers, procedures, regulations) has to be constructed around the requirements of entering into and discharging transactions in the market. Simply to list some of the needs is to gain an appreciation of the magnitude of the task.

- In many cases the constitution needs to be amended to eliminate the considerable proscriptions on private property and private property rights.
- Civil laws must be changed to institute resolution of disputes in ordinary courts of justice rather than through State arbitration, while adequate mechanisms for enforcement of decisions must be supplied.
- Property rights have to be established and relevant issues addressed--ownership, titling, transfer of property, succession, nationalization, expropriation, and the like.
- The body of commercial laws, often dating back to the last century, needs to be brought up to date.
- The legal framework for companies and their operations-- registration, liability--must be codified in new or revised company laws.
- The legal framework for restructuring, commercialization, and ultimately privatization of State enterprises must be established.
- Bankruptcy laws must be instituted and enforced.
- Competition legislation and legislation governing mergers and acquisitions must be addressed, along with patent licensing, trademarks, franchising, and dumping.
- As tax systems change toward (most likely) VAT and personal and corporate income tax systems, so too must legislation and administrative regulations be instituted.
- The market economy will require a separate and updated codification of labor laws.

This list could go on to include banking laws, laws governing capital markets and currency market operations, the criminal code, and so on.

^{20/} This section draws heavily on a memorandum by I. Newport.

In privatization legislation three steps appear basic: first, establishing clear ownership rights; second, setting clear rules for transforming enterprises into joint stock companies (and other forms of company organization); third, establishing clear and transparent procedures for privatization. Hungary provides an example of how difficult even this may be.

Hungary has perhaps marched farthest down the path of creating a legal framework for privatization through the passage of Company Law in 1988 and a Transformation Law in 1989. These establish the basis for transforming State enterprises and cooperatives into joint stock or limited liability companies. This legislation is seen, in many quarters, as being flawed, in that the Company Law failed to establish unambiguously the ownership rights of either the State or natural persons. Instead it appears to have devolved ownership to the enterprise itself, in effect "denationalizing" State assets and further sanctioning self-management.^{21/} With the Transformation Act of 1989, the legal position became sufficiently tangled to allow spontaneous privatizations.

This example highlights how privatization legislation is, in fact, the substantive reflection of political positions and interests. The creation of enterprise councils and the granting of de facto rights of self-management in previous years had created resistance to "re-nationalization," which was perceived as a return to the bad old days of administration from the center. The same tensions can be observed in the ongoing debates on Polish privatization (Poland introduced workers' councils in 1981). Clearly, unless basic issues are resolved early in the life cycle of legislation, privatization efforts can quickly run aground.

C. Enterprise Readiness for Privatization

A considerable constraining factor in privatizing is to ensure that enterprises are in reasonably healthy condition and will, in private hands, contribute to the overall objectives of the privatization program. Several actions are necessary before enterprises in socialist economies are let go to the private sector. These include demonopolization, enterprise valuation, and more generally enterprise restructuring.

D. Demonopolization

As noted earlier, socialist economies are highly monopolized; the average size of firms is considerably higher than in industrial economies. Socialist planning deliberately engineered this industrial structure, for it minimized the span of coordination and purportedly encouraged economies of scale. Enterprises are large, however, not simply because they are the sole supplier or one of few sources of products. Many enterprises have absorbed all manner of ancillary functions and businesses; a number of service functions have been internalized because of the uncertainties in manner of relying on outside suppliers. Most firms have extensive internal patterns of cross-subsidization that, given the poor state of accounts, are extraordinarily difficult to disentangle.

Breaking up large firms before selling them will not be simple. Multiple operations producing the same product at different geographical locations and with few economies of scale are an easy target. Most enterprises are far more complex than this. Distinguishing economies of scale and scope in enterprise organization, identifying the precise organizational components generating monopoly structure, assessing the compass of efficient vertical integration within firms, and devising plans for effective breakup will require considerable technical expertise. A single-minded attention to demonopolization will thus almost certainly delay privatization.

^{21/} See Mizsei (1990). Self-management was instituted through a State Enterprise Law in 1984.

For this reason, some commentators argue that the "monopoly" problem should be initially ignored. Policy should be aimed less at demonopolization than at preventing the abuses of dominant positions, discouraging collusion, and ensuring no unfair or illegal barriers to entry. A difficulty with this position is that the pursuit of uncompetitive practices after divestiture will add to the uncertainty of the environment into which firms are divested and where they must operate.

As noted earlier, most of the firms to be divested are not "natural" monopolies and are potentially competitive. Liberalized external trade is the primary force that will introduce competition into the economy and exercise price and quality discipline; indeed, there are a number of studies demonstrating the superiority for growth and welfare of an open rather than inward-looking orientation. While liberalized trade is undoubtedly to be recommended over the medium term, it is not clear that the countries with external difficulties and deep debt burdens (Bulgaria, Hungary, Poland) have the wherewithal to secure effective import penetration and competition any time soon.

E. Valuation

At what price should enterprises be sold? The value of a firm is often taken to be the discounted value of future after-tax net earnings. In conditions of highly distorted prices - both for outputs and inputs--it might appear that attempting correct valuation is chasing a chimera. It might even be questioned how valuable the exercise is, since in other countries public enterprises have been offered at discounts from market values.^{22/} In reforming socialist economies, great uncertainties about demand conditions, the business environment, the CMEA, and the like will make deep discounts inevitable. Nonetheless, correct valuation is important both as a matter of fairness to prospective investors and as a way to ensure that the State cannot be accused of "giving away" the national patrimony.

The rationale for valuation is often explained in terms of informational failures and asymmetries that the State should try to correct. Only those close to the enterprise (managers, workers, and some civil servants) with some knowledge of its capacities and markets are able to make an informed guess as to its future in a reformed economy. For reasons of fairness to other citizens and potential investors, this information should be made available to all. Public confidence in the privatization program can be quickly eroded if it appears that massive windfalls are accruing to purchasers with inside knowledge and through initial underpricing. (Recently the Hungarian courts stopped the sale of a hotel chain due to underpricing.) In effect, the case for attempting sensible--or at least defensible--valuations appears strong.

Several methods have been proposed to obtain these valuations. The first is to consider setting up stock markets. This approach has its problems. First, establishing stock markets does not eliminate the need to establish an initial price for an enterprise (that is, a valuation). Second, the belief that stock markets will actually establish "correct" valuation is, as Keynes suggested long ago, a myth: stock markets are locales for equity trading, for mounting battles for control, and for financial speculation. The extraordinary gyrations of stock prices in recent years should give automatic pause

^{22/} The British and French experiences are well-known in this regard. The share prices of British Petroleum, British Airways, and Rolls-Royce rose some 33-36 percent on the first day of trading after divestiture (Vickers and Yarrow 1988, p. 175). In France, the largest two privatizations (St. Gobain and Paribas), the discount was between 20-25 percent. It has been estimated that both in the British and French cases the revenue foregone by the privatizations amounted to about 10 percent of the gross proceeds (Jenkinson and Mayer 1988, p. 487).

to anyone suggesting that stock markets establish enterprise values.^{23/} A second suggestion is that the whole issue be finessed by simply valuing firms at their book value, perhaps corrected for inflation. A third suggestion is to "price" the capital stock of enterprises at replacement value through international comparisons and, with further guesswork, prepare plausible estimates. This method may buy respectability and may, in the absence of anything better, serve the purpose. But it will be expensive (and probably enrich a number of investment bankers), and it will take a long time to accomplish. The conclusion must be that there is no canonical method to provide precise, objective answers to the valuation problem.^{24/}

F. Enterprise Restructuring

That many enterprises in reforming socialist economies require restructuring is undoubted. But the magnitude of the restructuring problem is unknown. Indeed, it cannot be known until macroeconomic reforms (price liberalization, exchange rate convertibility, changes in tax systems, removal of subsidies, reform in the CMEA) work their way through enterprise income statements and balance sheets. The presumption must be that the problem is large.

There is a major question whether enterprises should be restructured before being privatized or whether restructuring should be left to the new, private owners. If the State sells unstructured enterprises, it will undoubtedly receive less revenue. This may not matter much, for it is extremely unlikely that governments can recoup the restructuring investments they make to prepare enterprises for private sale. In passing on restructuring problems to the new private owners, the State will pass on problems it has no particular expertise in solving. To create that expertise--and there are considerable doubts that a government body should even try--would require the establishment of a large and specialized administration.

An emerging conventional wisdom suggests:^{25/}

- Physical and technical restructuring is best left to the purchaser, who will do it better and more cheaply than the State; the purchase price should be discounted accordingly.
- Labor and management retrenchment is best handled by the State prior to sale; this invariably conflictual dimension of restructuring is too politically difficult to leave to new owners.
- Financial restructuring should be left to the private owner but almost always requires heavy State involvement. By and large, the State absorbs the enterprise debt and otherwise assists in cleaning up balance sheets.

^{23/} For further evidence on this point see Shiller (1981 and 1989). Nobel Laureate James Tobin, in citing evidence for errors in market valuations, comments: "I think developing and ex-communist countries should go slow in copying the financial institutions of the United States and the United Kingdom, or of Japan for that matter. When I read that Wall Streeters are visiting Beijing to help the People's Republic establish a stock market, I shudder. It is far from clear that the proliferation of financial instruments, market arbitrage opportunities, and paper transactions in advanced countries has created social product to justify the high-quality human capital resources it devours." Tobin (1990), p. 233.

^{24/} Durupty (1988), p. 66, provides an example in the case of Paribas Bank. Different forms of valuation and different consultants came up with a range of values from FF17.6 billion and FF21.5 billion--a difference in excess of 20 percent. The final value chosen by the Privatization Committee was FF17.5 billion.

^{25/} This section draws on a comment by J. Nellis.

The notion that there is a cadre of available owners capable of initiating and managing major restructurings needs to be proven correct. It is precisely a lack of faith that such a cadre exists that leads Kornai to argue for a somewhat slower pace of privatization.^{26/}

Restructuring requires skill, expertise, financial capital, and time. In Hungary, industrial restructuring has been ongoing since 1986-87 with the help of IBRD financing and technical assistance. It is too early to report on progress, although some success stories appear in the making. In Poland, there is discussion about forming a government-sponsored restructuring agency as well as a separate bank to take equity positions in companies about to be restructured. A special "restructuring levy" is imposed on all firms to provide financing.

G. The Financial Environment

The lack of well-developed capital markets is often seen as one of the most serious constraints to wholesale, quick divestiture of enterprises in East and Central Europe. The problem has many elements.

First, savings appear too small to purchase more than a fraction of the capital stock. Total private money savings in Poland are sufficient to buy 5 percent of enterprise assets at book value.^{27/} In Hungary, it has been suggested that "at present rates of domestic savings, it would take Hungarians hundreds of years to purchase all State enterprises."^{28/}

Second, throughout the region, banking systems are weak and underdeveloped. Two-tier banking systems are just emerging; competition between banks is limited; there are substantial problems of bad debts, arrears, portfolio difficulties, and mismatches between assets and liabilities. Household and enterprise credit circuits are far from well-integrated. There are very few specialized financial intermediaries. Merchant banks, which might advise enterprises on privatization strategies, do not exist. Banking systems, in short, suffer from such deep-seated financial difficulties--and are in such early stages of institutional and professional development--that they cannot contribute to the privatization process to the same degree as elsewhere.

Third, only Hungary has a stock market. It lists about 40 companies and has a capitalization of some \$116 million (1989)--about 0.5 percent of GDP.^{29/} It meets infrequently and--obviously--little gets traded; most shares are traded over the counter. There are no brokers, underwriters, institutional investors, or large money holders.^{30/}

Financial underdevelopment thus appears to place a serious constraint upon the quick sale of enterprises at prices approximating anything like their "real" values. One position is clearly to

^{26/} Kornai (1989).

^{27/} Reported in Walkowiak et al (1990), p. 71.

^{28/} Quoted in the report of the Blue Ribbon Commission (1990), p. 21.

^{29/} In Japan, capitalization is 150 percent of GDP. Some other figures are: Switzerland 110 percent, Britain 100 percent, United States 65 percent, France 35 percent, W. Germany 31 percent, Italy 22 percent. (From *The Economist*, Capitalism, Survey, May 5, 1990, p. 8.)

^{30/} Reference from *The International Economy*, April/May 1990, p. 69; Ilona Hardy "Eastern Europe's First Test Case."

recognize this, along with the other inhibiting factors, and to accept a slow, careful privatization process in which shares releases are commensurate with the ability of households, investors, and other potential owners to absorb the issue. The process can be calibrated roughly to the strengthening of the banking system, the establishment of stock markets, the development of specialized financial instruments, and the growth of domestic savings.

Paradoxically, on the other hand, a rapid privatization process is sometimes regarded as a mechanism for the quick development of capital markets and in particular securities markets. It is argued that issuing securities for sale would draw out much presently unrecorded foreign exchange holdings, including expatriated holdings. Purchase of the securities, moreover, could be financed through expansion of earmarked credit. (For an evaluation of credit expansion as a mechanism for facilitating purchases see Section III.) This view does not, unfortunately, meet all objections.

An important constraint lies also in prudent public disclosure requirements that publicly listed firms provide quantitative data and facts about their performance. In reforming socialist economies, few firms are presently capable of producing such data; acceptable accounting standards have yet to be established, and the accountancy and auditing professions are in their infancy. As a result, securities could be quickly created in great quantities—but the lack of public information on enterprises would render security trading meaningless and potentially open to manipulation, fraud, and other abuses.

H. The Fiscal Environment

The difficulties to successful privatization provided by unreformed fiscal systems is one of the least appreciated constraints. Virtually all reforming socialist economies inherit a system of turnover taxes, company (profit) taxes, and taxes on wages that together comprise the most important sources of revenue.^{31/} These taxes have been levied at enterprise-specific rates designed to affect the prices of goods and services and to facilitate redistributions of income between enterprises. The collection of taxes has been accompanied by numerous ad hoc interventions and by bargaining between enterprises and ministries. Taxes have rarely been set with a view to improving efficiency or enhancing growth.

This is not a propitious environment in which to privatize. The State's need to raise revenue may conflict with the absolute need to relinquish discretionary power over enterprise income. This tension will be heightened during the transition phase, for the State's revenue requirements will increase (to finance social assistance programs) even as it must establish clear, consistent, and nonarbitrary tax rules. Moreover, setting tax rates at high enough levels to meet revenue targets may well conflict with the desirability of providing incentives for savings, investment, and work effort. As firms are privatized, and as the private sector grows in size, a major administrative effort will be required to levy, assess, and collect taxes.

The overall fiscal impact of privatizations cannot be predicted in advance. While privatizations will bring in revenue in the short term, they will also signal the loss of dividends that the State has been implicitly collecting under various tax guises. Governments may no longer need to pay subsidies to privatized firms, but there may be short-term expenditures entailed in cleaning up enterprise balance sheets before divestiture. Furthermore, there may be substantial short-term costs in

^{31/} Hungary is the only country to have implemented a VAT and personal and corporate income tax systems. Poland proposes to introduce these taxes in 1991.

providing severance payments and unemployment compensation. Short-term losses, in fact, may need to be covered by general taxation.

I. The Administrative Environment

Implicit in much said above is the absence of administrative and institutional capacity to conduct privatizations. Virtually every survey of experiences in developing countries points to lack of implementation capacity and of developed financial markets as the major bottleneck in privatization.^{32/} In reforming socialist economies, the requirements for administrative initiatives extend well beyond a narrow privatization focus; they entail changing legal frameworks and the fiscal system, establishing demonopolization and restructuring capacity, and developing financial systems. The challenge is massive.

To stimulate and orchestrate privatizations, some countries appear to be opting for the establishment of privatization offices with a degree of parliamentary oversight. In Hungary, a State Privatization Agency was established in 1990. Such an agency appears to be the intent in the latest draft of Poland's privatization law.

III. TYPOLOGY OF PRIVATIZATION: ADVANTAGES AND DISADVANTAGES OF DIFFERENT OPTIONS

The various proposals advanced for privatizing the large State sectors of socialist economies can be classified by their answers to two basic questions:

- Should the assets be given away free or should the enterprises be sold?
- To whom should the assets be given or sold?

There are several groups of possible recipients. The list includes:

- "Inside owners"--workers and managers specific to an enterprise.
- All private individuals.
 - (1) Domestic citizens.
 - (2) Foreign citizens.
- Institutions.^{33/}
 - (1) Banks and other financial institutions.
 - (2) Holding companies.
 - (3) Pension funds.
 - (4) Universities, charities, and other worthy causes.
 - (5) Regional and local governments.

^{32/} See van de Walle (1989), Kikeri (1990), Hanke (1988) for reviews as well as citations for further references.

^{33/} Institutions will ultimately, of course, be owned either by individuals or by governments. If the former they could be subsumed as a subset of "individual ownership." However, because institutional ownership brings different characteristics to the process of privatization and potentially to the control of managers after privatization, it is treated as a separate category here.

The various combinations of answers to the two questions provide the universe of discussion. Table 1 attempts to put order to this discussion by identifying the main options.

In Table 1 we divide privatizations essentially into two types, internal and external, according to the target group of the privatization procedure.

In internal privatization, shares are given or sold exclusively to workers and/or managers employed in a firm, perhaps including those who have worked there in the past. Giving or selling enterprises to employee groups could occur rapidly or slowly. Employees, for instance, could acquire shares gradually: first borrowing the money to buy shares and then effectively acquiring them as the credit is repaid (the Employee Stock Ownership Plan [ESOP] model). There may be restrictions on the transfer of the shares. If shares have to remain with the work force, the model is that of a cooperative (or partnership) or a 100 percent employee-owned ESOP.

In external privatization, shares are given away or sold to individuals or groups that extend beyond the firm's boundaries. Bidders for an enterprise could comprise all private persons, institutions, and foreign investors. In this form of privatization, maximal holdings may initially be posited for particular groups (such as foreign investors, internal managers) for reasons of policy. Conversely, minimal holdings might also be posited (for the internal enterprise work force, for the population at large) for reasons of fairness or in order to spread both shareholdings and potential capital gain to as many people as possible. At the same time, secondary trading is encouraged in order to allow for the eventual emergence of majority owners or controlling interests.

Table 1. TARGET GROUPS OF DIFFERENT TYPES OF PRIVATIZATION

	INTERNAL	EXTERNAL
Sale of Shares	Workers (ESOP)	Private persons
	Employees	Institutions
		Banks
		Pension funds
		Holding companies
		Foreign investors
		Regional/local governments
Giveaway	Employees	Private persons
		Institutions
		Banks
		Pension funds
		Holding companies
		Regional/local governments

If enterprises are to be given away free, then two important cases of external privatization occur. First, free distribution to the whole population, and second, distribution to institutions, of which the most talked about option is distribution to holding companies. Holding companies introduce an additional step to the privatization process because, initially, enterprises are allocated to them. In turn they are expected later to bring the enterprises to market and sell them to private individuals. Shares in holding companies themselves may initially be given away, sold, or held by the state.

Each individual privatization may be, in effect, a combination of different privatization types. For example, 50 percent of an enterprise could be sold to the highest bidders, 30 percent distributed to all citizens, and 20 percent given away to employees. In this section we shall review briefly the main advantages and disadvantages of different privatization options. In doing so, we make use of a limited set of criteria to frame the discussion. Specifically we ask of the various models how they perform with respect to:

- Fairness.
- Speed of privatization.
- Monitoring and control of managerial performance.
- Revenue raising.

A. Internal privatization

Advantages. The main advantages of internal privatization are that it is administratively easy to implement, can be quite rapid, and is popular at least among workers in successful enterprises. They will own their enterprises and to that extent become masters of their fates. There is a general presumption that partly or fully employee-owned firms should be more productive than firms owned by outsiders, as employees will share directly in the increased profits from more intense effort.^{34/} Moreover, if the later market price of the company becomes substantially higher than the price at which the shares were acquired (which may often be zero) then, provided the shares can be sold to outsiders, strong capital gains may potentially be made. Administratively, problems of implementation are minimal: workers need to agree on a formula whereby shares will be distributed (for example, if pensioners or those who worked before in the firm would also receive some) and whether shareholding will be open to outsiders and under what conditions.^{35/} The transformation process may be spontaneous, with employees deciding more or less unilaterally to go private. The State's involvement may be minimal, other than setting a purchase price, as the modalities of the process are determined by employees alone.

Disadvantages. The most general problems with internal privatization were succinctly stated by Polish Minister of Industry Tadeusz Syryjczyk:^{36/}

What can be said to the argument that an enterprise belongs to its workers? That farmers, who through a long period carried the burden of industrialization, do not now have any right to national capital? And teachers and doctors? That a young man who works in a

^{34/} Whether in fact this is the case is largely an empirical matter. For a comprehensive review of the evidence, for a number of developed market economies, see the set of essays in A. Blinder (1990).

^{35/} In some privatizations envisaged in Poland (see Walkowiak, Breitkopf, and Jaszczynski 1990, p. 67), shareholding would be open to external investors but each of their shares would be worth one vote, while shares held by the employees could carry two or three votes.

^{36/} Quoted in Baczynski (1990).

factory for one year has a greater right to shares than a pensioner who worked in the same factory for 30 years. If this idea were put into practice, workers of rich enterprises would acquire huge capital, and others nothing.

In short, the procedure is highly unjust and inequalitarian: it excludes the general population, which has a claim to the entirety of national assets; it further discriminates between the employees of profitable and nonprofitable firms.

In practice, there has been a form of internal privatization in some of the spontaneous privatizations in Hungary and Poland, where a subset of employees--managers--have taken over ownership and control of firms. It is argued that managers, in taking the firms private, have manipulated workers into losing potential income of which they may have been unaware. If management tightly controls employees, it can ensure by bribery or coercion that they accept a privatization proposal favorable to management. No other group exists to protect the interests of the firm or to try to maximize the price at which it is sold. Features such as these have led to the administrative halt of internal privatizations in Poland, and to the decision of the Hungarian Parliament to establish the Fund for State Property. The role of the Fund is to watch over possible cases of fraudulent privatization and, if necessary, to overrule some purchases.

It should be noted that the inequity and inadvisability of internal privatization only refers to using it as a first stage privatization strategy. If enterprises are privatized through processes with greater respect for distributional justice, there appears little reason why managers or workers or both should not be allowed to engage in buy-outs. Judging from the experience in other countries, if shares are freely transferable, enterprises may eventually become externally owned joint stock companies.^{37/} Management buy-outs have also become a feature of a number of capitalist economies, particularly the U.S., in the last decade.^{38/} An advantage is that they do establish a coincidence of interests between managers and owners.

A third difficulty with internal privatization is that it will generate lower revenue for the State treasury than selling shares in an open market. In the interest of quick privatization--one of the main attractions of internal privatization--the State may agree upon share prices lower than a more careful and slow process of enterprise valuation would yield.^{39/}

^{37/} French experience, quoted in Uvalic (1989), pp. 47-48, suggests that workers tend to sell shares very quickly. For example, during 1982 privatizations around 10 percent of shares of a dozen large companies were reserved for employees. Most of the shares were bought by the management. Employees bought theirs principally for speculative reasons (to realize capital gains) and sold them quickly. The same seems to have been the case in the UK: the number of shareholders in British Aerospace passed from over 150,000 at the first day of quotation to 27,000 less than a year later (Santini 1986, p. 42). This gives an implied annual attrition of shareholders of 87 percent. For a few other privatizations (Amersham, British Gas, British Telecom, and British Airways) the attrition rates ranged between 12 and 75 percent p.a. (Milanovic 1989, p. 166).

^{38/} See the *Economist*, Survey, May 5, 1990, for a recent discussion of the U.S. phenomenon.

^{39/} In some cases of management buy-outs in Hungary, money paid for shares became part of net assets of the company. The effect was that the new owners simply received their firms as a gift. To understand this, suppose that the original value of a firm's assets is \$100. If a 20 percent purchase of shares of the firm - worth \$20 - becomes the property of the firm, the firm will now be worth \$120. But since the purchaser now owns 20 percent of the firm, he has in effect assets worth \$24 - the original investment plus a net gain of \$4. For somebody who buys the whole firm, the entire value of the firm is a present. That possibility seems also to have been opened by the *Yugoslav Law on Social Capital* (December 1989) in case of non-100 percent purchases of firms.

B. External Privatization--Giveaway to All Domestic Citizens

Advantages. The very great appeal of giving assets to people is that it is egalitarian. If properly conducted, no special group with access to money, credit, or power can exercise untoward influence in cornering the nation's wealth. It is also the simplest formula: it dispenses with arguments about any individual's past contribution to the buildup of the nation's or enterprise's wealth. It enfranchises all citizens with property and thus creates the political stake in the system that makes the reform program less likely to be derailed or reversed. Most important, compared to the alternatives, giving assets to the citizenry is considered one of the swifter ways of establishing the private property basis of a market economy and the capital market.

Disadvantages. Free distribution of shares, by definition, implies zero revenue for the State. Furthermore, it is sometimes argued that people do not value what is given to them for free. Distributing shares in this way fails to allow markets to perform their signalling function of bringing forward individuals truly interested in owning firms and prepared to risk their own financial capital in the expectation that they can earn substantial returns.^{40/}

In a sense, this latter proposition is a variant of a familiar principal-agent problem that characterizes this model. The highly dispersed ownership entailed in free distribution effectively means that there is no dominant owner (the principal) to monitor and control the actions of managers (the agents). Monitoring costs to small individual shareholders are high compared to the minor loss of income if managers don't perform as well as they should. This problem is not peculiar to reforming socialist economies; indeed, it has been analyzed in considerable depth for advanced, industrialized countries with well-developed financial systems. Partial solutions to the problem are found in giving managers bonuses and other incentives tied to firm performance. In addition, stock markets reputedly monitor enterprise performance. Poor performance is reflected in low share quotations, and managers who fail to deliver find that their enterprises are targets for takeover--and their own jobs are at risk.^{41/}

This analysis may bear some truth in advanced market economies. But in reforming socialist economies, the wholesale giving away of shares will allow managers an inordinate amount of power in the short term. Stock markets will take time to become established and to develop the sophistication to police and discipline bad managements. Of course, as shares are traded, individual investors who might originally have wished to own a particular enterprise will have an opportunity of doing so through share purchases. Given the initial low stocks of personal wealth, share concentration is likely to take time unless it is financed through borrowing. Thus there is the further possibility that the individuals most likely to engineer leveraged buy-outs of enterprises are the managers themselves.

Distributing shares to the population for free is sometimes regarded as disadvantageous because of the potential wealth effects upon consumption. These may be particularly unwelcome if they occur when economies are simultaneously undertaking stabilization programs. However, the problem may be reduced if the equity distribution is paced so as not inordinately to shift consumption upward in the short term.

^{40/} This is the substance of Kornai's recent criticism of giveaways.

^{41/} For a somewhat negative recent assessment of the effectiveness of the "battle for corporate control," see Adams and Brock (1989).

While it is generally assumed that wholesale distribution of shares could be done fairly easily, few detailed plans have yet been provided by proponents. In fact, the process could prove administratively difficult and costly. There are the daunting problems of registering all eligible prospective shareholders. Shares will need to be "issued" for each enterprise for distribution. An extraordinary distributional effort will be required. And a trading locus will need to be established for the shares.

Several schemes for packaging share distribution have been developed. The first is to bundle fractional ownership in all firms in multiunit shares that are then given to everyone. Thus each multiunit "supershare" is a composite fractional ownership claim on every firm in the economy. Dividends are paid on aggregate enterprise profitability. The concept appears to have little merit. If everyone owns everything then, in effect, no one owns anything. Stock markets can hardly be formed on this basis; shares will need to be unbundled into their components.

A second scheme consists less in equal distribution than in equal entitlement for people to bid for enterprises. Vouchers ("monopoly" money, capital tickets) are issued to all eligible citizens; these are then used for bidding. A citizen may, for instance, use all his million vouchers to bid for the shares of one firm--or he may bid over several firms. Bidding in this way establishes "voucher unit" enterprise valuation; as sales are consummated (vouchers exchanged for shares), ownership is established. The drawbacks are several. There will be strong informational asymmetries between potential purchasers, and between potential purchasers and the managers/workers of specific enterprises, as to which are the profitable firms. Bidding for most is likely to be guided as much by speculation and rumor as anything else. If many companies are offered at once, a very uneven distribution in bids may emerge, leaving some enterprises available for very little. Bidding for utility stocks, for instance, may be high, leaving few vouchers to bid for perfectly good firms. Quite exceptional windfall gains may result. Both these disadvantages speak to a lack of consequential fairness in what starts out as an egalitarian move.

A third scheme is not to distribute the shares directly, or through bidding, to the population. Rather, it involves giving enterprise shares to holding companies and then distributing the holding company shares to eligible citizens. In this way each citizen participates in a mutual fund. Because of its particular institutional features, this model is evaluated later in this section.

C. External Privatization - Sales to Individuals

Advantages. The primary advantage of external privatization via sales is that it allows the State to collect money through sale of enterprises at realistic prices. Taking the existing distribution of income as given, the model also allows for an optimum allocation of shares since, as for any other goods, they are purchased by those willing to pay the most. The purchase of firms by interested individuals precisely identifies those most likely to exercise ownership functions, particularly the monitoring of managerial performance. Once the State has established a reservation price for shares, sale could be mounted rather expeditiously through auctions. External privatization is fundamentally open to anyone.

Disadvantages. Unfortunately, the wide variety of constraints outlined in Section II above, inhibiting the divestiture of State assets, come into full play in the sale option. The process is likely to be egregiously slow.

The difficulties lie both in the condition of enterprises to be privatized and in the environment into which they are privatized; dearth of information, lack of liquidity, and underdevelopment of financial markets are the most prominent deficiencies. Given these problems, the State is faced with a choice: speed the "sale" of enterprises by accepting depressed prices and releasing unready firms to

the market, or crawl through a slow, steady process of valuation, restructuring, and marketing. The latter course may prove politically unacceptable.

A further general problem with sale to individuals is that the existing distribution of wealth will ultimately determine who buys shares and consequently the future concentration of ownership. Present wealth concentration is considered by many to be flawed. They argue that well-off people are not "socially deserving," either because they were too closely associated with the previous undemocratic regime or because they have made their money through foreign exchange deals, smuggling, or other semilegal or illegal activities. There are deep suspicions of foreign exchange caches held abroad by members of the *nomenklatura*. Such people, the argument goes, should not be allowed to "launder" ill-gotten gains and become respectable businessmen. Quite apart from the equity concerns are additional questions as to whether, in fact, such individuals or groups are likely to make "good" owners. Their professional backgrounds predispose them to seeking special privileges from the State rather than to competing in the marketplace.^{42/}

Since "nonworthy" groups are also likely to realize capital gains (from the initial underpricing or mispricing of assets), the equity implications of external privatization may be--according to this view--further flawed.^{43/} The real problem is whether the distribution of capital gains is done in accordance with the distribution of wealth. There may be good reasons to believe that it should not be. The fact that capital gains will indeed accrue to the rich segment of the population, and that concentration of wealth will increase, is a serious argument against selling as the only form of privatization. It is certainly an argument in favor of blending external privatization with other forms of privatization (say, distribution of shares to workers).^{44/}

One mechanism for getting around some of these problems is to give the population bank credit that may then be used to purchase shares. This seeks to speed the process of divestiture by circumventing institutional and market deficiencies. Since there is often confusion as to how this kind of scheme might work, it is worth some discussion:

- (1) In its simplest form the proposal suggests a massive expansion of bank notes earmarked for one specific purpose - to buy equity in enterprises. These bank notes are first given or credited to individuals. Once the equity purchases have been made, the money is either returned to the Central Bank or the notes are given to the government for spending. This is obviously tantamount to a giveaway of enterprises; the bank notes have simply been vouchers to exchange for ownership rights. If the Central Bank sterilizes the receipts, the

^{42/} Reported in Milor (1990).

^{43/} For the first eight French privatizations (up to May 1987), capital gains accrued disproportionately to better-off households. While only 2 percent of low-income French households bought shares, the proportion among top-income groups was 30 percent (Durupty 1988, p. 114).

^{44/} This blend appears in the latest draft of the Polish Law on Privatization, which would combine external and internal privatizations with the former being dominant. The law stipulates that once an enterprise is transformed into a joint-stock company it must sell at least 50 percent of its shares within two years to third (external) parties. However, 20 percent of shares will be sold on a preferential basis to workers. Kawalec (1989) similarly suggests in his proposal that workers be given 10 percent for free or at a nominal fee.

story ends there. If the bank notes are given to the government, then not only have households obtained enterprises for free but the government has money to spend.^{45/}

- (2) Instead of bank notes to buy equity, individuals and households could be offered loans. (This is the proposal of the Blue Ribbon Commission in Hungary.) The Central Bank could engineer a massive expansion of credit to households and individuals through banks or a specialized intermediary. Once again the credit would be earmarked only for buying equity. The proceeds of sale could be frozen by the Central Bank or, more likely, be appropriated by the government. The chief difference between this example and the earlier one is that households and individuals have acquired a liability--their bank loans--which they must repay out of future income.

In this respect the borrowers do genuinely buy title to the ownership claim. A difficulty with this scheme may be, however, that few individuals or households will have appropriate collateral. Proponents argue that the equities bought could serve as collateral. The effect, however, is to shift all risk to the financial institution. If the borrower cannot repay his loan, he defaults and loses his collateral--the shares he bought with the loan. In view of the shaky condition of the financial system, this course is not wise.^{46/}

In some schemes (such as those being discussed in Poland), it is suggested that to spur widespread ownership the interest on the loans be subsidized and tied to dividend payouts. This further reduces the costs and risks of borrowers.

If the government appropriates the receipts of sales, and spends them, the result might well be inflationary. For this reason the proceeds should be used only to retire internal or external debt.

Apart from using the credit instrument to facilitate sales, some thought has been given to the manner of sale. The choice narrows down to the government setting a price and selling directly to the public or the government selling the shares at auction (with or without a reservation price). In most developing countries the most popular technique has been sale to single owners.^{47/} As the volume of sales is likely to be large, this is not seriously contemplated in Eastern Europe. One idea has been to divide investors into several groups and to use information from one auction in setting the reservation price for the next auction. This is the notion underlying Kawalec's (1989) proposal that foreign investors would be allowed to bid only for the first 20 percent of shares (so that price would be relatively high and capital gain small). The price from the first round of auctions, reduced by say 10 to 20 percent, would then be used as the reservation price for the second auction, open to domestic investors only. Unsold shares would be kept by the government (as preferred shares) and sold later.

^{45/} Whether this is inflationary or not depends upon several factors, including the prior fiscal position, the size of the monetary emission, the speed with which the money is spent, capacity utilization in the economy, and so on. If the asset transfer is large, then the process will be inflationary. The permanent addition to household and individual wealth through the purchase of equity will, in either case, also likely result in increased domestic spending.

^{46/} This difficulty appeared in the Chilean privatizations, with disastrous consequences for certain segments of the banking system. See P. A. Yotopoulos (1989).

^{47/} See Nankani (1990), p. 44.

D. External Privatization--Foreign Investors

Advantages. Selling assets to foreigners is fairly straightforward and has two important putative benefits. First, foreigners are assumed to bring with them superior management, business know-how, and improved technology. Second, the country earns foreign exchange through the transaction.^{48/} There are other less obvious advantages such as opening the economy to outside influence, strengthening international links, and joining global networks of production. Liberalization and foreign involvement also help make reforms less reversible.

Disadvantages Few prescriptions in privatization debates appear to be as contentious as that of selling assets to foreigners.^{49/} The fear is the obvious one: that control over national assets, which represent the accumulation of decades of national savings and investment, will simply be turned over to outsiders. While most acknowledge the benefits of foreign participation, there are often proposals to limit such activity to a share of total national assets^{50/} or to a set number of enterprises.

Selling assets to foreigners does invite difficulties unless the transactions are well-managed. The economy faces the potential permanent loss of the net income stream generated by the foreign-held enterprise as net profits are remitted abroad. In general, this should not matter if the price at which the enterprise is sold is "right," since, in theory, the purchase sum could be invested to obtain the same return elsewhere. However, in situations of great uncertainty and with the inadequate valuation noted earlier, determining the correct price is far from easy. That this is not simply academic is illustrated by two recent and heavily criticized Hungarian transactions. In the first, shares in a major electric bulb manufacturer were sold to one foreign group, which then sold them to another at a 50 percent capital gain; in the second, an important vehicle manufacturer was effectively sold for a very small downpayment, with future payments to be made out of revenues.

E. External Privatization - The Role of Institutional Investors

External privatization will be open not only to individual investors but also to institutional investors--banks, pension funds, universities, trusts, insurance funds, mutual funds, and so on. In market economies, institutional investors are quite the most prominent form of investor. In the UK, for instance, a little less than two-thirds of all publicly quoted shares are held by institutional investors. In Japan and Italy, institutions hold more than three-quarters of all shares; such investors hold about one-half of total value of shares quoted at the New York Stock Exchange, with pension funds alone accounting for more than 10 percent. Controllers of large pools of financial assets, in short, are substantial owners in advanced capitalist societies.

Institutional investors do not exist in the reforming socialist economies. Where there is potential--banks, for instance--the institutions are almost entirely state-owned and will need to be converted into private companies before they can meaningfully take on an active role as private

^{48/} As noted earlier, the treasury may not see any of the money. In some of the recent "spontaneous transformations" in Hungary, the foreign exchange to purchase the firms remained either within the firms, i.e., they made gift of themselves, or with the banks which effectively "owned" the firms through large loans outstanding.

^{49/} This position is to be distinguished from allowing foreigners to form new companies. Virtually all countries have few restrictions on foreign capital forming new joint ventures or establishing new enterprises.

^{50/} In a recent proposal on holding companies in Poland, it has been suggested that foreigners be limited to holding 10 percent of holding company stock.

stockholders in other firms. This will, in the case of banks, require a cleaning up of portfolios and injection of new capital along with considerable institution building. The question about the role of institutional investors in the privatization process is thus the broader question of whether institutional investing provides a useful social service beyond that provided by small investors and whether, therefore, institutional investors should be encouraged and developed.

According to some views, the advantages of institutional investors reside in their better ability to monitor a firm's managers. This comes because institutions tend to be large shareholders and thus find it in their interest to develop greater capacity than individuals to track and assess enterprise performance. As large shareholders, they can more easily replace a poor management team. Specialization also allows economies of scale; it facilitates higher degrees of professionalism than is available to the small investor and thus allows institutional investors to make better portfolio decisions. In some cases, institutional investors, because of their close interest in and greater leverage over enterprise affairs, may provide professional services to enterprises to assist them in making better decisions.

These propositions, drawn from general considerations, are not universally accepted. Some, for instance, remain dubious about the claim that institutional investors outperform individuals in the quality of investment decisions.^{51/} Nor is it clear that all institutional investors are particularly interested in taking up supervisory directorships in companies or that they would be professionally suited for such tasks.

Nonetheless, the broader point is that privatization provides an opportunity to foster the financial sector, not simply through developing security markets but also through creating or strengthening institutions that may play a prominent future role as lenders of financial capital or as holders of equity.

In this respect, the roles of banks, pension funds, and holding companies (see next section) need further analysis. In the case of commercial banks, several channels for development appear available. First, as has happened in Hungary and Yugoslavia, banks may convert some of the badly performing loans on their books into equity; these holdings may then be sold, or else banks may proceed to restructure the poorly performing enterprises. Second, banks could independently invest in equity of enterprises without first converting bad loans. In the West German model, banks have traditionally had an important role as financiers and stockholders in their clients. Through holding proxy voting rights for small investors, they have secured seats as directors on the supervisory boards of enterprises.^{52/} They provide professional advice and expertise to clients, often well beyond that of normal "finance." Moreover, they are the country's only legal stockbrokers; firms that wish to acquire a public quotation have to go through a bank.^{53/} Opinion naturally differs on how efficient, effective, and responsive this system is. Nonetheless it does provide a point of departure for considering the role of banks in East Europe's privatization process. This is especially so since financial and capital market skills are so scarce and the "infrastructure" of capital markets does not exist.

^{51/} See B. Malkiel (1985).

^{52/} In 1980 bank directors held about 10 percent of seats in the hundred largest corporations. Quoted in Carson (1990).

^{53/} Ibid p. 628.

The case for developing pension funds as institutional investors consists of two arguments: first, intergenerational equity and second, giving pension schemes a sound financial footing in the early stages of the reform process. Insofar as national assets are to be parcelled out to individuals or groups, it seems just and fair to reserve some fraction for pensions. This will ensure that a proportion of the future income flows generated from today's assets will be used to finance the retirement of current and prior generations of workers. The alternatives are to have company-based pension schemes or to use the general revenue to finance retirement. Company-based schemes, at the present juncture, would be highly discriminatory, since the performance and prospects of different companies vary greatly. Establishing pension funds that hold diversified portfolios of assets overcomes this problem from the worker's perspective. As important, it also relieves (perhaps only partially to begin with) the treasury of having to use scarce tax revenues to pay for worker retirements, since these can be financed through the dividends received from enterprises.

F. Holding Companies^{54/}

In view of the many difficulties in the divestiture models discussed above, holding companies are frequently discussed as possible vehicles for privatization.^{55/} Proposals come in many varieties but essentially comprise three components: first, most enterprises in the economy are either given to or sold to holding companies; second, shares in holding companies are either sold or given to the public (including, in some proposals, to foreign investors); third, holding companies themselves are expected to exercise some management and restructuring functions and eventually to bring the enterprises under their control to market.

Advantages. The main advantage of the holding company model is that it allows for fast privatization (if shares in the holding companies are sold or distributed free to the population). Moreover, because of the pooling of enterprises in holding companies, shares in these are likely to be intrinsically less risky. This is a factor of some advantage in conditions of limited and dispersed information and where a culture of holding financial assets is just beginning to be established. Holding companies, moreover, could sever ties between enterprises and ministries and thus cut the informal links and bargaining over credits, subsidies, tax preferences, and so on that have traditionally bedeviled reform efforts. Holding companies could also, in principle, exercise ownership interest on behalf of their shareholders and implement much-needed reforms at the enterprise level to improve performance.

Disadvantages. Despite such advantages, there are questions about potential operations. Are not holding companies in fact the "same old system" except at one remove? To transform the "owners" of enterprises from founding organs to holding companies requires no great magic. What will be more difficult to achieve will be to insulate holding companies from political pressures and allow them the mandate to make some very difficult decisions concerning enterprise restructuring - plant closures, layoffs, redundancies, and ultimately privatization. Great power will be granted to small boards of (unelected) officials to take some highly visible decisions. Holding companies could become "captives" of the enterprises they own or of the government.

Because of these difficulties there is a danger that "slow" privatization will become no privatization at all. Through inertia or the exercise of political power, holdings will not be divested to the public.

54/ The following comments have benefited from notes prepared by A. Gelb, J. Nellis, and G. Yarrow.

55/ Holding companies are being used in Algeria as the main instrument for securing divestiture. Experience to date, however, is insufficient to draw any general conclusions.

A further question is whether, in fact, holding companies will be able to provide the kind of management required effectively to monitor and oversee the firms they own. To the extent that businesses are specialized, the answer must be no. Moreover, it is increasingly apparent that management contracts, leases, and various other devices that may be used to establish arms-length incentive contracts with enterprise management⁵⁶ are difficult to devise and difficult to administer. The improvements sought in enterprise performance through improved management via holding companies may not materialize. Indeed, some opponents suggest that holding companies should not even get into the business of enterprise restructuring, for they have no special expertise.

CONCLUSIONS

An essay largely devoted to a taxonomic discussion of objectives, constraints, and models of divestiture in privatization programs does not yield to easy summary. Some concluding observations are nonetheless possible.

The plethora of divestiture options does not simplify choice. From an individual perspective the choice of preferred model will vary depending upon the choice of objectives, the weights given to the objectives, and the appreciation (or dismissal) of practical difficulties in implementation. In this respect there is no "correct" answer about how to privatize. Decisions are highly political, mediated through still emerging processes, invoking strong interests and lobbies, and with a genuine possibility of popular backlash in societies sensitive to wide divergences of wealth. Howsoever privatization strategies emerge from this process, certain questions deserve continuing reflection. Should the privatization process be fast or slow? Does the State need the revenues from privatization? Should enterprises be demonopolized before being privatized? Should enterprises be financially and technically restructured before being privatized, or can this be left to new owners? How can ownership arrangements be instituted so that the new owners take an interest in performance? All these questions involve multidimensional, and not simple, answers.

Divestiture models are not exclusive. It may be perfectly possible, in fact, to combine giving workers and managers a stake in their firms, granting a proportion of enterprise equity to the general population (either directly or through institutions), and obtaining revenue for the State through general sales. These "combination" options are beginning to surface in privatization debates and deserve considerably more elaboration and defense than they have had thus far.

Whether privatization is fast or slow is really only relative. Even in the best of scenarios, it is unlikely that the majority of State assets can be divested in less than a few years. The near-complete unpreparedness of the legal, financial, and fiscal environments underpin this expectation.

During this period when firms are readied for divestiture, it may be expected that governments will be besieged by waves of requests for exemptions, concessions, protection, and so on, from firms about to be privatized or from new owners. It will be extremely important to resist these pressures. The improvement in economic performance that is one of the major objectives of reform programs will be considerably diluted if the new market economy is based on an extensive network of special privileges. Moreover, experience from elsewhere testifies to the difficulty of removing concessions once given. It is imperative therefore not only that the privatization process be seen to be transparent and absolutely above reproach but that the rules of the "market" game are also clearly enunciated and adhered to in divestitures.

^{56/} See Newport (1989) and Nellis (1988).

Divestiture will be an integral aspect of the development of financial sectors. The continuing evolution of banking systems, pension funds, insurance companies, securities markets, and the like will all be shaped by decisions concerning the depth, scale, speed, and mechanisms of privatization. There is great benefit in considering these complex issues together. In particular, a pure "case-by-case" approach to the privatization process may well miss out on substantial opportunities to strengthen and help construct a modern and sophisticated financial system. Indeed, unless the strategies for financial sector development and privatization are coordinated, weaknesses in the former may lead to ad hoc and perhaps haphazard approaches to privatization. The activities of privatization offices should, in this regard, be subordinated to this wider perspective.

Finally, governments will need to pay attention to the majority of State enterprises that will take time to be privatized or are otherwise left in their ward. Encouraging a market orientation and fostering responsiveness to economic signals in these enterprises will present a major challenge. The wide variety of incentive devices--management contracts, leases, bonuses tied to performance--should be explored in this context. As important, governments must ensure that there is no discrimination favoring State enterprises (credit allocation, State orders, looser financial discipline), in contrast to the rules for the developing private sector.

BIBLIOGRAPHY

- Adams, Waller, and James W. Brock. 1989. *Dangerous Pursuits: Mergers and Acquisitions in the Age of Wall Street*. New York: Pantheon Books.
- Baczynski, Jerzy. 1990. "Dla ubogich." *Polityka*, March 3: p. 4.
- Bishop, Matthew R. and John A. Kay. 1989. "Privatization in the United Kingdom: Lessons from Experience." *World Development*, May: pp. 643-57.
- Blinder, A. 1990. *Paying for Productivity: A Look at the Evidence*. Washington, DC: The Brookings Institution.
- Brittan, Samuel. 1988. *A Restatement of Economic Liberalism*. Atlantic Highlands, NJ: Humanities Press International.
- Bugaj, Ryszard. 1989. "Dispute over the Paradigm of Reform." *Zmiany*, No.7, June 18.
- Carson, Richard L. 1990. *Comparative Economic Systems*. Armonk, NY: Sharpe.
- Durupt, Michel. 1988. "Les Privatisations en France," *Notes et Etudes Documentaires*, No. 4857.
- The Economist. 1990. "Privatization in Eastern Europe." April 14; "Survey, Perestroika." April 28; "Survey, Capitalism." May 5.
- Friedman, Milton. 1962. *Capitalism and Freedom*. Chicago: University of Chicago Press.
- Havek, Friedrich A. 1944. Reprint 1976. *The Road to Serfdom*. Chicago: University of Chicago Press.
- Hanke, Steve H. 1987. *"Privatization and Development"*. International Center for Economic Growth.
- Hinds, Manuel. 1990. "Issues in the Introduction of Market Forces in Eastern European Socialist Economies." Washington, DC: World Bank. Mimeo.
- Horvat, Branko. 1989. *ABC jugoslavenskog socijalizma*. Zagreb: Globus.
- Jenkinson, Tim, and Colin Mayer. 1988. "The Privatization Process in France and the UK." *European Economic Review*, No. 32: pp. 482-90.
- Kawalec, Stefan. 1989. "Privatization of the Polish Economy." *Communist Economies*, No.3: pp. 241-56.
- Kornai, Janos. 1986. "The Hungarian Reform Process: Visions, Hopes, and Reality." *Journal of Economic Literature*, December: pp. 1687-1737.
- . 1990. *The Road to a Free Economy*. New York: W.W. Norton and Co.
- Malkiel, Burton. 1985. *A Random Walk Down Wall Street*, 4th Edition. New York: W.W. Norton and Co.

- Milanovic, Branko. 1989. *Liberalization and Entrepreneurship*. New York: M.E. Sharpe.
- Mises, Ludwig von. 1951. First published in German in 1922. *Socialism: An Economic and Sociological Analysis*. New Haven: Yale University Press.
- Nankani, Helen. 1990. "Lessons of Privatization in Developing Countries." *Finance and Development*, March.
- Nellis, John. 1988. "Contract Plans and Public Enterprise Performance." *PPR Working Paper*. Washington, DC: World Bank.
- Sarjusz-Wolski, Marek. 1989. "Self-management versus Liberalism: Enterprise Autonomy the Only Common Bond." *Przegląd Tygodniowy*, No. 47.
- Scherer, F. and Ross. 1990. *Industrial Market Structure and Economic Performance*, 3rd Edition. Boston: Houghton-Mifflin.
- Schumpeter, Joseph A. 1943. *Capitalism, Socialism, and Democracy*. Cambridge, MA: Unwin Press.
- Shiller, Robert. 1981. "Do Stock Prices Move Too Much To Be Justified By Subsequent Changes in Dividends?" *American Economic Review*, 71, October: pp. 421-36.
- , 1990. *Market Volatility*. Cambridge, MA: MIT Press.
- Tobin, James. 1990. "One or Two Cheers for the 'Invisible Hand.'" *Dissent*, Spring.
- Uvalic, Milica. 1989. *Profit Sharing Schemes in Western Europe*. Florence: European University Institute.
- van de Walle, Nicolas. 1989. "Privatization in Developing Countries: A Review of the Issues." *World Development*, May: pp. 601-15.
- Vickers, John, and George Yarrow. 1988. *Privatization, An Economic Analysis*. Cambridge, MA: MIT Press.
- Walkowiak, Witold, Mikolaj Breitkopf, and Dariusz Jaszczynski. 1990. "Private Sector and Privatization in Poland." Paper presented at Conference on Privatization and Ownership Changes in Central and East Europe, Washington, DC, June 1990.
- Waltens, Alan. *Privatization*, mimeo. no date.
- Yarrow, George. 1986. "Privatization in Theory and Practice." *Economic Policy*, April: p. 323.

PRE Working Paper Series

	<u>Title</u>	<u>Author</u>	<u>Date</u>	<u>Contact for paper</u>
WPS742	The Cost of the District Hospital: A Case Study from Malawi	A. J. Mills		
WPS743	Antidumping Enforcement in the European Community	Angelika Eymann Ludger Schuknecht	August 1991	N. Artis 37947
WPS744	Stainless Steel in Sweden: Anti- dumping Attacks Good International Citizenship	Gunnar Fors	August 1991	N. Artis 37947
WPS745	The Meaning of "Unfair in U.S. Import Policy	J. Michael Finger	August 1991	N. Artis 37947
WPS746	The Impact of Regulation on Financial Intermediation	Dimitri Vittas	August 1991	W. Pitayatonakarn 37666
WPS747	Credit Policies in Japan and Korea: A Review of the Literature	Dimitri Vittas	August 1991	W. Pitayatonakarn 37666
WPS748	European Trade Patterns After the Transition	Oleh Havrylyshyn Lant Pritchett	August 1991	N. Castillo 37947
WPS749	Hedging Commodity Price Risks in Papua New Guinea	Stijn Claessens Jonathan Coleman	August 1991	S. Lipscomb 33718
WPS750	Reforming and Privatizing Poland's Road Freight Industry	Esra Bennathan Jeffrey Gutman Louis Thompson	August 1991	B. Gregory 33744
WPS751	A Consumption-Based Direct Tax for Countries in Transition from Socialism	Charles E. McLure, Jr.	August 1991	CECSE 37188
WPS752	Inflation and Stabilization in Yugoslavia	Roberto de Rezende Rocha	August 1991	L. Ly 37352
WPS753	The CMEA System of Trade and Payments: The Legacy and the Aftermath of Its Termination	Martin Schrenk	August 1991	CECSE 37188
WPS754	Estimating Returns to Scale with Large Imperfect Panels	James R. Tybout M. Daniel Westbrook	August 1991	S. Fallon 37947
WPS755	Hedging Crude Oil Imports in Developing Countries	Stijn Claessens Panos Varangis	August 1991	D. Gustafson 33714
WPS756	Taxes Versus Quotas: The Case of Cocoa Exports	Arvind Panagariya Maurice Schiff	August 1991	S. Fallon 37947
WPS757	Managing the Transition: Enhancing the Efficiency of Eastern European Governments	Eric Rice	August 1991	P. Infante 37642

PRE Working Paper Series

	<u>Title</u>	<u>Author</u>	<u>Date</u>	<u>Contact for paper</u>
WPS758	Is There Excess Co-Movement of Primary Commodity Prices? A Co-Integration Test	Theodosios B. Palaskas Panos N. Varangis	August 1991	D. Gustafson 33714
WPS759	The Profamilia Family Planning Program, Columbia: An Economic Perspective	Jesus Amadeo Dov Chernichovsky Gabriel Ojeda	August 1991	O. Nadora 31091
WPS760	How Conflicting Definitions of "Manufactures" Distort Output and Trade Statistics	Alexander J. Yeats	September 1991	J. Jacobson 33710
WPS761	Uncertainty and the Discrepancy between Rate-of-Return Estimates at Project Appraisal and Project Completion	Gerhard Pohl Dubravko Mihaljek	September 1991	P. Lee 81950
WPS762	Debt, Debt Relief, and Growth: A Bargaining Approach	Daniel Cohen Thierry Verdier	September 1991	S. King-Watson 31047
WPS763	A Valuation Formula for LDC Debt	Daniel Cohen	September 1991	S. King-Watson 31047
WPS764	African Financing Needs in the 1990s	Jorge Culagovski Victor Gabor Maria Cristina Germany Charles P. Humphreys		
WPS765	Withholding Taxes and International Bank Credit Terms	Harry Huizinga	September 1991	S. King-Watson 31047
WPS766	Economic Crisis, Structural Adjustment, and Health in Africa	Francois Diop Kenneth Hill Ismail Sirageldin	September 1991	O. Nadora 31091
WPS767	Framework for Macroeconomic Analysis (Applied to Kenya)	Colin A. Bruce David Ndi	September 1991	M. Lynch 34046
WPS768	Going to Market: Privatization in Central and Eastern Europe	Manuel Hinds Gerhard Pohl	September 1991	L. R. Hovsepian 37297
WPS769	Entry-Exit, Learning, and Productivity Change: Evidence from Chile	Lili Liu	September 1991	D. Ballantyne 37947
WPS770	Privatization in Eastern and Central Europe: Objectives, Constraints, and Models of Divestiture	Farid Dhanji Branko Milanovic	September 1991	CECSE 37188